Statement of Lawrence "Doc" Cohen
President, DOC & Associates, Ltd.
Past Chairman, International Franchise Association

Before the House Committee on Small Business

Hearing on *Laying the Groundwork for Economic Recovery: Expanding Small Business Access to Capital*

June 10, 2009

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Good afternoon Chairwoman Velázquez, Ranking Member Graves and members of the committee. My name is Doc Cohen, and I am grateful to have the opportunity to speak to you today about the credit crunch facing small business entrepreneurs and the need for strong measures to promote capital access. During my statement, I will make three key points:

1. Credit is the lifeblood of small businesses;
2. While SBA programs typically support borrowers who cannot obtain financing through commercial sources without the SBA guarantee, this is not a typical recession and many more small businesses need the capital access programs of the SBA in order to obtain financing. This means that policymakers should be willing to consider, even temporarily, further changes to SBA programs including increases in the dollar amounts for SBA 7(a) loan guarantees to accommodate the needs of larger- and intermediate-sized small businesses; and,
3. The fastest way to kick start the American economy into a sustainable recovery will be to target categories of businesses that can create and sustain the most jobs. I believe a compelling case exists that franchised businesses offer the best opportunity for policymakers to promote a strong and sustainable recovery.

I am the Founder and CEO of DOC & Associates, based in Tomball, Texas, and a leading franchisee of the Great American Cookie Company. I have served as the Chairman of the Board of Directors of the International Franchise Association (IFA) and was the first franchisee to earn the designation of "Certified Franchise Executive" given by the IFA Educational Foundation. As the largest and oldest franchising trade group, the IFA's mission is to safeguard the business environment for franchising worldwide. IFA represents more than 85 industries, including more than 11,000 franchisee, 1,200 franchisor and 600 supplier members nationwide. According to a 2008 study conducted for the IFA Educational Foundation, there are more than 900,000 franchised establishments in the U.S., creating 21 million American jobs and generating $2.3 trillion in economic output. I am proud to represent franchising. The business methods, training and support I have received as a franchisee have been one of the keys to my success.

My franchise, Great American Cookies, began in 1977 when the first store location opened in Atlanta's Perimeter Mall. Founded on the strength of a generations-old family chocolate chip cookie recipe, the company eventually set the standard for gourmet cookie sales in shopping centers nationwide. From one store and one recipe, Great American Cookies expanded in malls across the country and developed a complete line of cookies and brownies, including our signature Cookie Cake product. Currently, there are over 300 Great American Cookie locations in the United States.

Today, I sit before you an experienced entrepreneur. From my first Great American Cookie Company in Lafayette, Louisiana thirty years ago, financed with help from my sister and brother-in-law, I now operate 30 stores in the Houston, Texas area, employing almost 300 people. I was fortunate that when I began my career in franchising, there was a functioning credit market, including the SBA loan guarantee program. I can say that the SBA loan programs helped me and my business succeed in franchising. After my first store, I came to the Agency three times to finance subsequent expansion. Today's small business entrepreneurs are not so lucky. Under normal circumstances, small businesses can tap financing from a number of different sources, including the SBA loan programs. During this recession, however, most commercial lenders have dramatically curbed their willingness to assume risk. Some credit might be available, but the terms and delays that entrepreneurs are encountering can be staggering.

Last year, I was presented with opportunities to add eight new locations. I had previously acquired a reducing line of credit with a major bank in the amount of $1.5 million. In early 2008, I had approximately $1 million available on the line. By the end of 2008, and with two locations remaining to be built, it appeared that I would need an additional $500,000 and asked to increase our credit line back to the original $1.5 million. The answer I was given by my lender wasn't quite "no;" but the terms being offered in late 2008 had become extremely restrictive. I was told that I could borrow the additional $500,000 that I needed, but only if I agreed to keep $1 million in liquid assets on deposit with the lender. Fortunately, I no longer need my brother-in-law; but even with an extensive track record of successfully opening new units and a relatively healthy balance sheet, my lender was unable to provide the financing under acceptable terms. Facing unacceptable credit terms, I chose to forego the additional borrowing, take a personal risk and finance the two new stores on my own, using cash generated from operations. The eight stores that I opened required a capital investment of $1.8 million and created 74 new direct jobs. It is unlikely, however, that I will consider opening additional stores until the restrictions on credit are eased and until small business regains its ability to access the capital necessary to fuel expansion and growth.

The current crisis is keeping America's entrepreneurs on the sidelines and the negative impact this is having on our country's economy could not be more real. Small businesses are struggling to access the capital needed to stay open, pay debts, maintain payroll and expand operations. The problem is even worse for those looking to get into business for themselves for the first time.

Capital investments in small businesses create jobs, and according to the SBA, small businesses have created 60 to 80 percent of new jobs annually over the last decade. The findings of the recently released study, *Small Business Lending Matrix and Analysis*, prepared for the IFA Educational Foundation, support the notion that meaningful economic recovery and meaningful job creation will start with small business lending. In fact, the study determined that for every $1 million in new small business lending, the franchise business sector would create 34.1 jobs and generate $3.6 million in economic output.

Franchised businesses play an important role in the economic health of the U.S. economy, and they are poised to help lead the economy on the path to recovery. IFA Educational Foundation reports show that the franchise industry consistently outperforms the non-franchised business sector, creating more jobs and economic activity in local communities across the country. Released in February, 2008, *Volume 2 of the Economic Impact of Franchised Businesses*, for example, documents that franchising grew at a faster pace than many other sectors of the economy from 2001 to 2005, expanding by more than 18 percent. During this time, franchise business output increased 40 percent compared to 26 percent for all businesses. The message is clear, Madam Chairwoman, provide small business entrepreneurs and franchisees with access to capital, and we will create jobs.

Earlier this year, Congress and the new Administration worked quickly to address the current economic crisis. The stimulus plan authorized the spending of nearly $800 billion, including more than $650 million targeted at small business lending. The recovery bill made important changes to SBA programs such as a temporary increase in the loan guarantee from 75 percent up to a maximum of 90 percent, and the bill suspended loan fees for borrowers that can add up to 3.75 percent to the cost of a loan. These are crucial steps, but far more needs to be done to support small businesses.

Since passage of the American Recovery and Reinvestment Act, the Administration has announced further action to address the availability of credit. In March, President Obama and Treasury Secretary Geithner announced that the federal government would use $15 billion to purchase SBA guaranteed loans from the secondary market in order to help new loans flow. Unfortunately, the rollout of this initiative stalled when financially healthy industry partners refused to abide by the intrusive terms of the federal bailout. As a result, franchised businesses and prospective franchise investors with strong credit histories remain in limbo and loan applications continue to be denied or delayed.

The franchise business community believes that there are several steps that Congress should consider to make it easier for entrepreneurs to access capital and create jobs. Congress should increase the standard 7(a) maximum loan limit from $2 million to $4 million and increase the maximum guarantee amount provided to $3.6 million. The economic downturn has resulted in borrowers having less collateral due to declining home values and reduced investment and savings accounts. Increasing the loan limit will allow more individuals and businesses to take advantage of the 7(a) program, expanding the job creation potential of the program.

I would urge you to also consider examining a market-based loan pricing model for the SBA loan programs. The real issue for many small business borrowers is not so much the cost of funds as it is the basic availability of funds. When SBA programs cap the interest rates that can be charged by lenders, the rules create a competitive disadvantage for small business borrowers. Despite the best intentions of policymakers, capital will not flow to markets that offer below market rates, and guarantees and borrower discounts alone will not change the dynamics of a bank's simple risk versus return analysis. Smaller, thinly capitalized firms cannot compete for scarce capital resources with larger firms paying market rates, and financial institutions are more likely to lend money to a better capitalized firm offering an opportunity for a greater return. In my view, this is a major market breakdown that has blunted the impact of changing the guarantee rate and reducing fees and Congress should respond.

In April, the General Accounting Office reported that SBA lending activity has begun picking up pace. While that may be true, many franchised businesses continue to report that they are still struggling to find capital. Do not mistake the increased activity of mortgage refinancing for the start-up financing that small businesses need. Mortgage refinancing in the small business sector is not going to promote the kind of job creation and recovery that Congress intended. Therefore, the IFA strongly recommends that this Committee look at new ways to stimulate small business lending so that funds are available for business start up and expansion. One recommendation would be to reserve a portion of the available loan proceeds solely for business start-ups and expansion. This would ensure that the SBA guarantee programs are supporting real job creation.

While we are here to examine steps to improve the climate for small business lending, I must note that, unbelievably, the SBA has actually created new regulatory roadblocks for small businesses. On March 1st, the SBA published a new version of its Standard Operating Procedure (SOP) that included a significant change regarding goodwill financing of business transfers and acquisitions. In a departure from long-standing practices, the SBA opted to place a cap on the amount of “goodwill” that can be financed through the SBA’s guaranteed loan program. Since the value of many small businesses is based primarily on the cash flow it can generate rather than the value of the assets it has on its books, the new policy has had the impact of placing an arbitrary limit on the valuation of some businesses. In franchising, this change also threatens to curb the valuation of all franchisees in a system, not just a store that is being transferred to a new owner.

The SBA has indicated that it will grant exceptions on the policy while it collects data on loans involving goodwill submitted after March 1, 2009. The agency has also said that it will reconsider the policy for revision in September. The IFA would recommend that in order to adequately analyze transactions that involve goodwill financing, the SBA should entirely rescind the newly established cap of $250,000 on goodwill financing while the data is gathered. Keeping in place an arbitrary rule will continue to undermine the Agency’s ability to effectively evaluate the policy.

Finally, I would suggest that the solution to adequately addressing the economic struggles facing small businesses is for the federal government to promote more lending—not more federal government spending. As shown my experiences and the hundreds of thousands of small franchised businesses in every local community, lending leads to more sustainable and renewable job growth and economic recovery.

I want to again thank the members of the Committee for the opportunity to participate in today’s important hearing on laying the groundwork for economic recovery and expanding small business access to capital. I think you will agree that the franchised business community can play a significant role in these efforts.

Thank you.